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No. 72-312

In the Supreme Court of the United States

OCTOBER TERM, 1972

MERRILL LYNCH, PIERCE, FENNER & SMITH,
PETITIONER

v.

DAVID WARE, ET AL., RESPONDENTS

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE DISTRICT

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

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CITATIONS

Cases:

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This memorandum is filed in response to the Court's order of November 13, 1972, inviting the Solicitor General to express the views of the United States in this case.

STATEMENT

Petitioner, Merrill Lynch, Pierce, Fenner & Smith, Inc., is a member organization of the New York Stock Exchange. It has a profit-sharing plan for employees, which provides that an employee who voluntarily terminates his employment and engages in an occupation competitive with Merrill Lynch forfeits his vested interest in the plan (Pet. App. 3). Respondent

292-053—72——1

is a former account executive of Merrill Lynch, employed in California, who voluntarily terminated his employment with that firm and became an employee of a competing securities broker. He initiated this suit in a state court in California, seeking his accrued share of the profit-sharing rights, which Merrill Lynch claimed to have been forfeited. He contended that the forfeiture provision was invalid under California Business and Professions Code 16600, which makes void any contract to the extent that it restrains an individual from engaging in a lawful occupation (Pet. App. 2).[1]

After answering, Merrill Lynch petitioned for an order compelling arbitration and staying the proceeding. It relied on a New York Stock Exchange form signed by Mr. Ware which provided, in conformity with NYSE Rule 345 (Pet. App. 13), for approval by the Exchange of his employment as a registered representative of Merrill Lynch. In this form he agreed to abide by the Constitution and Rules of the Exchange (Pet. App. 17), including Rule 347(b), which requires that any controversy between an employee and a member organization arising out of employment or its termination be settled by arbitration (Pet. App. 20, 21, 22).

The trial court denied Merrill Lynch's petition without opinion (Pet. 1), and Merrill Lynch appealed.

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[1] California Business and Professions Code 16600, provides, in pertinent part:

"* * * every contact by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

The California Court of Appeal sustained the trial court's action, holding: (1) that there was a valid contract between Merrill Lynch and Ware to arbitrate this dispute; (2) that the forfeiture provision of the Merrill Lynch plan was an unlawful restraint of trade under California Business and Professions Code 16600 and that it was thus unenforceable in California; and (3) that Ware's action was a suit for "wages" and thus could be maintained under California Labor Code 229[2] without regard to the arbitration agreement (Pet. App. 5–11). The court's opinion also authorized the trial court to consider other issues raised by the pleadings prior to entry of judgment (Pet. App. 12). Subsequently, the California Supreme Court denied Merrill Lynch's timely petition for a hearing (Pet. 1).

DISCUSSION

The government believes that no question is presented warranting review by this Court. The court of appeal's decision does not conflict with federal policy governing arbitration of employment disputes; the application to this case of *Silver* v. *New York Stock Exchange*, 373 U.S. 341, is not properly presented on this record; and the application of the California law

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[2] California Labor Code 229, provides:

"Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate. This section shall not apply to claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement."

against restraints on engaging in a lawful business does not burden interstate commerce.[3]

1. Merrill Lynch points out, as it did below, that the securities industry is regulated. The Securities Exchange Act of 1934 subjects the industry to regulatory oversight by the Securities and Exchange Commission and provides for supervised self-regulation by exchanges such as the New York Stock Exchange ("the Exchange"). The Exchange has promulgated rules pursuant to Section 6 of the Securities Exchange Act, 15 U.S.C. 78f, by which respondent agreed to abide. Because the Exchange has provided for compulsory arbitration of disputes between member firms and their employees, Merrill Lynch relies on the federal policy, expressed most clearly in Section 301 of the Labor Management Relations Act, 29 U.S.C. 185(a), favoring arbitration of labor-management disputes. See *Textile Workers Union* v. *Lincoln Mills*, 353 U.S. 448.

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[3] There is also, as respondent contends, a substantial argument that the state court's decree is not "final" under 28 U.S.C. 1257. In *Baltimore Contractors, Inc.* v. *Bodinger*, 348 U.S. 176, a diversity suit for an accounting of profits, this Court stated that a district judge's order denying a stay of action pending arbitration because there was no valid agreement between the parties to arbitrate was not a "final decision" appealable to the court of appeals under 28 U.S.C. 1291. See also *Sand Springs Home* v. *Naharkey*, 299 U.S. 588 (state court judgment ruling on question otherwise reviewable by this Court held not final because it also directed a remand for an account upon which a further decree was to be entered); *Grays Harbor Logging Co.* v. *Coats-Fordney Co.*, 243 U.S. 251 (state court judgment that a taking by eminent domain was for a public use held not "final" under a predecessor to 28 U.S.C. 1257, where the amount of compensation had not yet been determined).

The federal policy favoring arbitration reflected in Section 301 of the Labor Management Relations Act is not applicable here. That statute applies only to questions arising under collective bargaining agreements. Respondent's profit-sharing rights flowed not from such an agreement but from an individual contract with Merrill Lynch. Moreover, Section 229 of the California Labor Code is by its terms inapplicable to "claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement." See n. 2, *supra*. A similar exemption is expressed in the Federal Arbitration Act, which is inapplicable to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in * * * commerce." 9 U.S.C. 1.[4]

In any event, cases concerning both commercial and labor arbitration indicate that where a claimant's legal action is founded essentially on a statutory right—as is Ware's claim that under California law he is entitled to his accrued benefits under the profit-sharing plan—the right to sue is not defeated by an agreement to arbitrate. Thus, in *Wilko* v. *Swan*, 346 U.S. 427, this Court allowed a purchaser of securities to bring a damage suit under the Securities Act of 1933, despite an arbitration provision in the margin agreement. Although acknowledging "the desirability of arbitration as an alternative to the complications of litigation," this Court concluded that "the special

[4] But cf. *Dickstein* v. *duPont*, 443 F. 2d 783, 785 (C.A. 1), stating that the federal exemption is generally limited to employees engaged in the actual movement of goods in commerce.

right to recover for misrepresentation" afforded by Congress would be diluted by depriving the purchaser of his right to litigate. Similarly, in *Arguelles* v. *U.S. Bulk Carriers, Inc.*, 400 U.S. 351, a seaman was permitted to litigate under federal statutes providing redress to seamen allegedly denied prompt and proper payment of wages, despite a provision in the applicable collective bargaining agreement for arbitration of such disputes.[4]

Thus, the general federal policy favoring arbitration does not require that Ware be forced to arbitrate his claim based on the California Business and Professions Code.

2. Merrill Lynch argues further that since federal antitrust law is to some extent "subservient to" provisions of the Exchange rules promulgated under the self-regulatory function given national stock ex-

[4] See also *McKinney* v. *Missouri-K.T.R. Co.*, 357 U.S 265, 268 (returning servicemen not obliged to pursue remedies available under the grievance procedure set forth in the collective bargaining agreement before bringing a court action under Section 9(d) of the Universal Military Training and Service Act); *Thompson* v. *Iowa Beef Packers, Inc.*, 185 N.W. 2d 738 (S. Ct. of Iowa), certiorari dismissed as improvidently granted, 405 U.S. 228 (employees not obliged to exhaust grievance-arbitration procedures of the collective bargaining agreement before bringing a court suit under Section 16(b) of the Fair Labor Standards Act to recover overtime compensation due under that Act). Compare *Republic Steel Corp.* v. *Maddox*, 379 U.S. 650 (requiring arbitration where employee, bypassing contractual grievance procedure, sued employer in state court to collective severance pay pursuant to the collective agreement); *Dickstein* v. *duPont*, 443 F. 2d 783 (C.A. 1) (employee forced to arbitrate contract claim), discussed *infra*, pp. 12–13.

changes under the Securities Exchange Act of 1934, state law—such as California Labor Code 229 and California Business and Professions Code 16600—should be similarly subservient to the Exchange rules. Citing *Silver* v. *New York Stock Exchange*, 373 U.S. 341, Merrill Lynch urges that refusing arbitration frustrates the federal policy of self-regulation by making member firms and their employees settle their disputes in court; it characterizes the arbitration provisions as lying "at the heart of the registration process designed to screen those employees of member firms dealing with the public" and as "precisely the kind of self-regulatory provision called for in the 1934 Act" (Pet. 11).

(a) In *Silver,* which involved a particular instance of enforcement of Exchange rules over which the Securities and Exchange Commission had no regulatory jurisdiction (373 U.S. 357), this Court held:

> The Securities Exchange Act contains no express exemption from the antitrust laws or, *for that matter, from any other statute.* This means that any repealer of the antitrust laws must be discerned as a matter of implication; and "[i]t is a cardinal principle of construction that repeals by implication are not favored". Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes [Emphasis added; citations omitted].

Silver also indicated that the burden is on the Exchange to show that its rule is necessary to accomplish that objective. 373 U.S. at 364–365.[6]

We submit that "the principle that exchange self-regulation is to be regarded as justified in response to antitrust charges only to the extent necessary to protect the achievement of the aims of the Securities Exchange Act" (*Silver,* 373 U.S. at 361)—at least with respect to Exchange practices beyond the supervision of the Securities and Exchange Commission [7]—is equally applicable in reconciling, under the Supremacy Clause or the doctrine of preemption, the Securities Exchange Act with state law governing the activities of an exchange or its members. That inquiry, in turn, requires a full development of all the pertinent facts relating to the self-regulatory functioning of the exchange with respect to the subject

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[6] The Antitrust Division of the Department of Justice and the Securities and Exchange Commission are in disagreement over the basis upon which the Securities Exchange Act and the antitrust laws are to be reconciled with respect to Exchange practices subject to the regulatory jurisdiction of the Commission. The Commission's position is that the propriety of such stock exchange rules and practices is to be tested by the Commission under the standards of the Securities Exchange Act without regard to the standards of the antitrust laws. The Antitrust Division, on the other hand, believes that the existence of Commission authority to review exchange rules confers no antitrust immunity; that such immunity exists only upon demonstration that the immunity is necessary to make the Securities Exchange Act work; and that that determination is to be made by a court. Cf. *Thill Securities Corporation* v. *New York Stock Exchange*, 433 F. 2d 264 (C.A. 7), certiorari denied, 401 U.S. 994. As explained in this memorandum, this case is not an appropriate vehicle to resolve that issue.

[7] See note 6, *supra.*

matter to which state law is sought to be applied, and a detailed and discriminating application of the pertinent legal and policy considerations to the facts thus developed. No record on these issues was developed in the California courts, however, and those courts were never requested to and did not make such inquiry or analysis.

While, so far as we are aware, the particular Exchange rule here in issue has never been determined to be either within or beyond the Commission's regulatory authority, even that issue was not raised below. Nor was there any analysis of the extent to which, if at all, supersession of state law by the Exchange rule was "necessary to make the Securities Exchange Act work" (*Silver, supra,* 373 U.S. at 357). Although Merrill Lynch contended in the trial court that the securities industry was "highly regulated," it did so in the context of arguing that a valid contract to arbitrate existed between itself and Ware.[8] *Silver* was not cited. In the California Court of Appeal, Merrill Lynch reviewed extensively the regulatory framework of the securities industry, but again the thrust of its argument was to establish that there was, in contractual terms (*i.e.,* mutuality of obligation, consideration), a valid agreement to arbitrate which was enforceable by Merrill Lynch.[9]

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[8] See Merrill Lynch Petition to Compel Arbitration, 1 R., 134–135; Merrill Lynch Reply Memorandum, 1 R., 191–192. ("R." references are to the two-volume record in this case, on file with the Clerk of this Court.)

[9] See Merrill Lynch Brief in the California Court of Appeal, 2 R., Ex. A., 33–39.

With regard to the validity of the forfeiture provision in its profit-sharing plan, Merrill Lynch's primary argument on ap-

Since there is not an adequate record on these issues and the California courts did not decide them, it would be inappropriate for this Court to consider them.

(b) Aside from the *Silver* issue, Merrill Lynch's argument ignores the general rule that state and federal antitrust claims are not arbitrable, even where the claim is asserted as a defense to an otherwise valid contractual duty to arbitrate. In *Associated Milk Dealers, Inc.* v. *Milk Drivers Union*, 422 F. 2d 546, 552 (C.A. 7), the court held that "to await the arbitrator's award before allowing the defense of illegality to be raised would be contrary to sound policy. Illegality under the antitrust laws concerns broad public interests transcending the private objectives of the parties."[10] Accord, *Power Replacements, Inc.* v. *Air Pre-*

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peal was that the provision was valid under California law. It did state, following this argument, that "[e]ven assuming that no significant factual distinction exists between a pension plan as in *Muggill* [v. *Rueben H. Donnelly Corp.*, 62 Cal. 2d 239, 398 P. 2d 147] and a Profit Sharing Plan, as here, there is serious doubt as to whether state law is paramount to the federal regulatory policies embodied in the securities laws." Merrill Lynch Brief in the California Court of Appeal, 2 R., Ex. A, 50. However, Merrill Lynch's brief moves from this statement directly to an argument that a state antitrust law may not make illegal that which is legal under the federal antitrust statutes. *Id.* at 51–54. Again, *Silver* was not cited at this point, nor was the court requested to make the type of analysis required by *Silver*.

[10] In *Associated Milk Dealers, Inc., supra*, responding to an argument by the party invoking the arbitration clause that the arbitrator could consider whether the challenged contract provision violated the antitrust laws, the court stated (422 F. 2d at 552):

"We disagree. Arbitrators are ill-equipped to interpret the antitrust laws and their consideration of possible violations

heater Co., 426 F. 2d 980 (C.A. 9); *A. & E. Plastik Pak Co.* v. *Monsanto Co.*, 396 F. 2d 710 (C.A. 9); *American Safety Equipment Corp.* v. *J. P. Maguire & Co.*, 391 F. 2d 821 (C.A. 2); *Aimcee Wholesale Corporation* v. *Tomar Products, Inc.*, 21 N.Y. 2d 621, 237 N.E. 2d 223 (holding state antitrust claims not arbitrable). See also Pitofsky, *Arbitration and Antitrust Enforcement*, 44 N.Y.U. L. Rev. 1072 (1969); Aksen, *Arbitration and Antitrust—Are They Compatible?*, 44 N.Y.U. L. Rev. 1097 (1969).[11]

Coenen v. *R. W. Pressprich & Co.*, 453 F. 2d 1209 (C.A. 2), is not to the contrary. Indeed, the court expressly acknowledged that the general rule was that antitrust claims were not arbitrable; however, it affirmed a stay of an action by an allied member of the Exchange against a member firm under the Exchange compulsory arbitration rules solely on the ground that plaintiff's agreement to arbitrate was made after the dispute arose. Such cases are recognized as exceptions

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would add little. Indeed an agreement requiring arbitration of private antitrust claims would probably be unenforceable, *Silver-cup Bakers, Inc.* v. *Fink Baking Corp.*, 273 F. Supp. 159, 162 (S.D. N.Y. 1967). Thus we hold that if the union can establish that Article 20 * * * is illegal [under the antitrust laws], arbitration of the dispute between the parties is not required."

[11] The author of the latter article, the General Counsel of the American Arbitration Association, urged re-examination of the law holding antitrust and arbitration incompatible. However, he described the present state of the law as follows (44 N.Y.U. L. Rev. at 1097):

"There is almost unanimous concurrence by ample judicial authorities that arbitrators are not permitted to resolve violations of antitrust laws, and it makes no difference whether the dispute involves a collective agreement, or whether state or federal antitrust policy is under consideration."

to the rule that antitrust claims are not arbitrable, since a post-dispute promise to arbitrate may be regarded as equivalent to an agreement to settle an existing private action. 453 F. 2d at 1215.[12]

(c) The holding of *Dickstein* v. *duPont*, 443 F. 2d 783 (C.A. 1), is not inconsistent with the result here. There, a registered representative employed by an Exchange member firm sued for breach of contract because his employer had paid him an allegedly inadequate finder's fee, and urged that his arbitration agreement was illegal under the Sherman Act. The district court stayed the action pending arbitration, noting at the outset that under *American Safety Equip.*, *supra*, resolution of plaintiff's Sherman Act claim was a matter for the court and not the arbitrators. The court then stated that it was not readily apparent that conditioning approval of employment on submission of disputes to arbitration was anticompetitive and alternately that assuming there was a restraint of trade, the arbitration provision "does not derogate from the self-regulatory grant of the Securities [Exchange] Act." 320 F. Supp. 150 at 153–154 (D. Mass.).

The court of appeals affirmed, stating that plaintiff, by asserting that the agreement to arbitrate violated the antitrust laws, stood in the same position as one who seeks to defend a contract suit by asserting that the contract itself is illegal under the antitrust laws, and that under *Kelly* v. *Kosuga*, 358 U.S. 516, such defenses may not be raised unless "the intrinsic illegal-

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[12] In addition, the court characterized plaintiff's complaint as containing "no more than perfunctory and formal allegations of an antitrust claim * * *." 453 F. 2d at 1215.

ity of the contract is so clear that enforcement would make a court party to the precise conduct forbidden by the law." 443 F. 2d at 786. The court of appeals then examined plantiff's antitrust claim in detail, concluding that it had no merit. *Id.* at 786–788.[13]

Applying this general approach to the present case, Ware's underlying claim is, as the California courts held, well-founded on the state statute condemning forfeiture provisions as restraints of trade. His challenge to application of the compulsory arbitration provision does not rest on a speculative claim that such provisions in and of themselves violate the federal antitrust laws. Rather, it too is well grounded in state law, and the California court implicitly concluded that enforcing the arbitration provision would, in the language of *Kelly, supra,* 358 U.S. at 520, "make the courts a party to the carrying out of the very restraints forbidden by the" Labor Code.

3. Finally, Merrill Lynch contends that imposition upon it of diverse state standards relating to restraints on its employees amounts to an undue burden upon its ability to operate in interstate commerce. But in

[13] It was thus unnecessary for the court of appeals in *Dickstein* to reach its alternative ground of decision that the exchange's arbitration rule was within "the self-regulatory grant of the Securities Exchange Act which is a partial exception to the antitrust laws." 443 F. 2d at 787–788. The Antitrust Division further believes that although the court in *Dickstein* suggested that the plaintiff had "to prove the rule was outside the self-regulatory grant of the Securities Act" (443 F. 2d at 787), both *Silver* and *Thill*, *supra*, indicate that the burden of justification is on the Exchange. The court in *Dickstein* also made no mention of the substantial body of law, discussed above, that antitrust claims are not arbitrable.

this respect, its situation is no different from that of any other corporation operating nationally which is subject to the varying provisions of state law governing relationships with individual employees,[14] at least insofar as not superseded by federal law. That the state law involved may in part reflect state competitive policy makes no difference.

It is well-recognized that state laws preserving competition can effectively complement federal antitrust policy, and even, in the exercise of the state's reserved police powers, go beyond it, so long as the functioning of the federal system is not disturbed. Cf. *Standard Oil Co.* v. *Tennessee,* 217 U.S. 413, 421–422; *Puerto Rico* v. *Shell Co.,* 302 U.S. 253, 261–263. See, *e.g.,* Flynn, *Federalism adn State Antitrust Regulation,* 80–96, 150–180 (1'64); Note, *The Commerce Clause and State Antitrust Regulation,* 61 Col. L. Rev. 1469 (1961). This Court's dictum in *Flood* v. *Kuhn,* 407 U.S. 258, 284, concerning application of state antitrust laws to the special situation of professional baseball is not to the contrary, since application of the California law, as this record now stands, does not conflict with federal policy.

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[14] Merrill Lynch acknowledges (Pet. 12) that other states have, apparently without challenge in this Court, similarly condemned forfeiture provisions of the kind involved herein.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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